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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Soviet Indebtedness To The West

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
November 1970

INTELLIGENCE MEMORANDUM

Soviet Indebtedness To The West

Introduction

Soviet indebtedness to the West, accrued from medium- and long-term credits, has grown rapidly in recent years concomitant with an upsurge in imports of Western plant and equipment. Soviet indebtedness reached more than US $1 billion by the end of 1969 and will go higher this year. This memorandum describes the developments in the growth of Soviet trade and debt with the developed West and examines the prospects for the near term.

The Genesis of Soviet Debt

1. Soviet use of Western medium- and long-term credit is a recent phenomenon in Soviet history. During the first four decades of its existence, the USSR conducted virtually all of its international transactions with the West on a cash basis. The practice stemmed in large part from its treatment as an outlaw by the Western powers in the 1920s when the Soviet state was refused credit of any kind. By the end of the 1920s the USSR was able to attract some credit, but on short terms only and at very high interest rates. In the main, however, the USSR paid cash and exported gold to meet its debts when export receipts were insufficient. Throughout this period the USSR was careful to meet its commitments on time and, by the late 1930s, it had established for itself a reputation as a trading partner which met its commercial obligations.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research.

2. The exclusively cash basis of conducting international commercial transactions with the West endured after World War II until the late 1950s. Gold sales continued to be the basic means to settle deficits in its international accounts with the West. Persistent deficits, however, resulted in a moderate drain on Soviet gold reserves which fell from a high of about $3 billion in 1955 to $2.5 billion four years later. With the ambitious seven-year plan (1959-65) coming up and the decision to purchase large amounts of Western plant and equipment, Khrushchev decided that Western credit could help bridge the gap between exports and imports. With the easing of East-West tensions, the promise of a growing market in the East, and increasing competition among Western suppliers, the time was ripe for the USSR to elicit credit from the capitalists.

3. Between 1959 and 1965, trade with the West as a whole grew at the annual rate of nearly 11%, exceeding $5 billion in 1965; Soviet hard currency trade with Western countries grew at a rate of more than 19%, imports growing at a more rapid rate than exports (see Tables 1 and 2). This growth came at a time when almost all of the major trading partners of the developed West had returned their currencies to a convertible basis.*

4. In line with Soviet policy a sizable deficit developed in trade with hard currency countries in the early 1960s, as imports of industrial goods rose rapidly. In 1963 and 1965, however, poor grain harvests forced the USSR to import substantial quantities of wheat (roughly $1.2 billion in 1963-65 alone) from hard currency countries. As a result of these unexpected imports, the hard currency trade deficit increased to an average of $350 million a year. In 1963-65 the USSR resorted to sales of gold which averaged more than $500 million per year (see Table 3). Gold reserves, which had continued declining in 1960-62 to a level of about

* *Bilateral clearing arrangements with the USSR were rapidly terminated. In the early 1960s only Austria, Finland, Norway, and Sweden remained as Soviet clearing partners. Norway and Sweden returned to hard currency trade with the USSR in 1965 and Austria will do so in 1971.*

$2.1 billion, fell by more than $1 billion during 1963-65, reaching a low of about $1 billion by the end of 1965 (see Table 5).

5. To prevent even larger deficits and further drawdowns on depleted gold reserves, Khrushchev's successors reduced imports of industrial goods and expanded exports at a faster rate after 1964 than in the previous five years. Short-term borrowing was also increased.*

6. During 1964-65 the USSR cut back its orders for Western plants and equipment (see Table 6). These orders had been partly financed by medium-term credits from the West, but by 1963 mounting repayments had more or less offset new credits (see Table 4). The reductions in known orders from the West in 1964-65 were made despite an increasing Western willingness to furnish medium-term or even longer term credit during this period. Soviet failure to take advantage of these easier credit terms probably stemmed from Soviet uncertainty about crop prospects and about its ability to expand exports.

Recent Developments, 1966-69

7. The cutbacks in orders and industrial imports from the developed West and the expansion of traditional Soviet exports to that area brought the USSR its first hard currency trade surplus in a decade in 1967. Machinery and equipment imports from the developed West, however, had returned to their earlier high level in 1966 and increased to a new high of $670 million in 1967. This trend was more than rising exports to the area could match, and Soviet trade with the hard currency countries returned to a deficit position in 1968.

* *Soviet use of short-term credit was continuous throughout the 1960s. With the cessation of large Soviet gold sales, however, the USSR has placed increasing reliance on such facilities to help finance deficits. The USSR also has been active in the Eurocurrency market and is typically a net borrower.*

8. In 1969 the Soviet hard currency trade deficit rose to more than $300 million. Soviet exports have continued to increase but at a substantially lower rate than imports. The deficit has been financed through both short-term and long-term credits, with the USSR continuing to husband its gold. There have been no significant sales of gold by the Soviet Union since 1965. Soviet gold reserves increased each year in the 1966-69 period, reaching an estimated $1.6 billion at the end of 1969.

Soviet Policy on Credits from the West

9. The USSR under Khrushchev financed deficits by drawing on gold reserves and using only a moderate amount of medium-term credits. Once the volume of new medium-term credits leveled off, however, repayments soon caught up. The sharply increased drain of hard currency brought on by the grain crisis threatened to decimate the Soviet gold reserves. The current leadership, having first ended the gold drain and brought a measure of stability to the Soviet hard currency payments position, more recently has been able to boost industrial imports through the use of long-term credits. This spurt too can only be temporary, as the credits will eventually have to be repaid.

10. Annual drawings increased from an estimated $60 million in 1959 to $180 million in 1962 (see Table 4), but they then varied little until 1966 when they jumped to about $275 million. By 1969 they had almost doubled again, reaching $525 million. New drawings, which were just balancing repayments by 1963 because of the rapid growth of repayments with the use of medium-term credits, increased sharply in 1965 and afterward when long-term credits became the principal form of Soviet borrowing. Thus the Soviet debt to the West, which grew from about $50 million to $380 million in the seven years 1959-65, rose to almost $1.2 billion in the four years 1966-69. The average duration of outstanding credits had changed from five years in 1959 to eight years in 1969.

11. The rapid growth and present size of the Soviet debt to the West indicates that the current regime is willing to incur substantial foreign debt to obtain Western equipment and technology. At the same time, the USSR seems intent on rebuilding the gold reserve that had fallen to about $1 billion in 1965. The USSR thus has added some $600 million to its reserves, but at a cost of adding about $800 million to its long-term debt to the West. The level of indebtedness is not so great as to impose a serious financial burden on the USSR. The present regime demonstrated in 1964-65 that it will not hesitate to curtail orders and imports from the West if it believes that its international financial solvency is threatened. Nevertheless, this debt does impose an additional constraint upon the USSR, which plans to continue to increase imports of Western plants and equipment but which has had considerable difficulty in meeting plans to expand exports.

Recent Credit Activities

12. Recent Soviet credit contracts have shown an awareness of the need to generate exports to the West if the hard currency debt is not to become an eventual drag on imports of technology and hence on the economy. The USSR has sought increasingly to tie the repayment terms for major plant and equipment orders to deliveries of the product from the resulting installation. An example of this type of contract has been the Soviet-Japanese timber agreement of 1968 in which $133 million in Japanese equipment to exploit Siberian timberlands was to be financed by Japan on a five-year credit, with repayment tied to deliveries of wood products to Japan. Other examples of this type of credit arrangement have been the gas-for-pipe contracts the USSR has signed with Austria, Italy, and West Germany. Basically these contracts call for long-term (up to 10 years) credits for some $650 million in Western pipe and pipeline equipment with repayment usually tied to Soviet sales of natural gas to these countries. Soviet gas sales to Austria and Italy will involve sizable hard currency earnings for the USSR over the 23-year and

20-year periods of the gas contracts because the pipe and equipment which made possible these sales will be paid for by gas delivered through 1977.*

13. The Soviet Union has also proposed a number of cooperative arrangements with Western countries calling for Western long-term credits for equipment to exploit Soviet natural resources. How serious the USSR is about these proposals, which have been made to Japan, the United Kingdom, and France, is uncertain since most have been overly ambitious, calling for credits in the hundreds of millions of dollars, longer terms than usual -- some from 10 to 20 years -- and deferred payments in the form of deliveries of Soviet goods produced by the projects. None of these deals seem likely to be completed until the scope and terms become more realistic for the proposed Western partners.

Prospects

14. Soviet hard currency imports of plants and equipment in 1970 are expected to continue at the high level of recent years despite the fall-off in known Soviet orders of plants and equipment from the West in 1969. Helping to keep these imports at a high level are the normal lag between orders and deliveries, the delivery of items held up on Soviet request in 1969 (mostly items for the Soviet FIAT plant), continued large deliveries of steel products, and the increased deliveries on the pipe contracts.

15. Orders for industrial plants and equipment continue to lag in 1970, totaling only about $200 million through August. Several major proposals in the process of negotiation have dragged on with no decision. Among them are a French

Soviet earnings from gas after 1977 are expected to be about $24 million per year from Austria and $67 million per year from Italy. The West German pipe contract, by far the largest at $330 million, could involve some hard currency outlay by the USSR, since it calls for repayment in 10 years, but this would be recouped in the hard currency earnings during the last 10 years of the 20-year contract.

pipe-for-gas proposal, a Japanese proposal for $350 million worth of equipment in exchange for Soviet pulpwood and wood chips, and a number of proposals for Western chemical plants. Uncertainty on the shape of the new five-year plan (1971-75), a decision not expected before early 1971, may be responsible for this delay. Unless orders pick up soon, plant and equipment deliveries may be down in 1971. Such a development, however, probably would have a short-term effect. The USSR seems likely to continue its import program and to reach agreement on many of the above proposals. Further evidence of Soviet intentions to import at a high level is a proposal in the $500 million import range for a truck plant on the Kama River now being discussed with Western countries.

16. The Soviet debt to the West probably will increase in 1970 because of the large deliveries on the Italian and German pipe contracts, while other plant and equipment deliveries apparently will remain at about the same level as in 1969. These deliveries are expected to bring drawings in 1970 close to $800 million and to increase both net credits and indebtedness by about $400 million. Soviet indebtedness to the West will stand at approximately $1.6 billion by the end of the year. Pipe and plant equipment, as well as steel deliveries, should remain high for the next few years -- even if deliveries dip in 1971 -- and the debt should continue to rise, although possibly at a reduced rate. For the longer run, Soviet ability to service this debt will be a function of their ability to generate and sustain increasing exports. Imports of plant and equipment under contracts specifying long-term exports of the ensuing products will help to provide that capability.

17. Soviet exports to the hard currency area, which have failed to keep pace with the rapid growth in imports from that area since 1966, are unlikely to show any unusual rise in 1970. Net exports of petroleum, traditionally the largest hard currency earner, are not expected to increase and may decline, and there is no indication that other traditional export items

such as wood and cotton will rise substantially. Exports of diamonds, which have enjoyed a substantial growth in recent years, probably will not grow as rapidly this year because of substantially reduced demand. The hard currency deficit in 1970, thus, may be on the same order of magnitude as in 1969, but it almost certainly can be financed without gold sales.

Conclusions

18. More than a decade ago the USSR embarked on a program to modernize Soviet technology by increasing imports of machinery and equipment from the developed West. Khrushchev's initial policy was to pay for these imports by borrowing from the developed West and by selling gold when credits were unavailable. The grain failures of 1963 and 1965 forced large gold sales and also compelled the USSR to cut back on imports of industrial goods from the West.

19. When the need for grain imports declined and the Soviet hard currency trade balance was restored, the USSR again increased industrial imports from the West. The present Soviet leadership has chosen to rely to a greater extent on Western long-term credit to finance these purchases. Soviet debt to the West rose by about $800 million from 1965 to 1969, and will probably be about $1.6 billion by the end of 1970. During 1966-70 Soviet gold sales will have been negligible. Gold reserves will have risen from a low of $1 billion at the end of 1965 to about $1.8 billion at the close of 1970.

20. Soviet trade with the developed West seems likely to continue growing in the next several years, with the help of Western credits. Neither the USSR nor its Western partners seem to regard the present size of the Soviet debt to the West as unmanageable. The USSR has sought arrangements with the West calling for even longer term credits and repayments in Soviet goods produced by the installations financed by these credits. Optimistic Soviet demands for huge credits and extended length of repayment have resulted in few completed contracts in 1970, but the USSR seems determined to pursue this line of economic policy.

Table 1

Soviet Trade Turnover with the Free World a/

Million US $

	1959	1965	1967	1968	1969
Total	*2,602*	*5,067*	*5,866*	*6,543*	*7,604*
Hard currency countries b/	1,126	2,877	3,292	3,900	4,531
Developed West	1,636	3,039	3,668	4,195	4,725
Hard currency countries	854	2,455	2,997	3,518	3,993
Less developed countries	845	1,756	1,768	1,833	2,287
Hard currency countries	282	481	331	410	567
Unspecified	121	272	430	515	593

a. Because of rounding, components may not add to the totals shown.
b. Total adjusted to exclude Soviet economic aid deliveries to less developed countries and aid repayments from these countries made in goods.

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Table 2

Soviet Trade with Hard Currency Countries

Million US $

	1959		1965		1967		1968		1969	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Total a/	*538*	*588*	*1,331*	*1,546*	*1,688*	*1,604*	*1,896*	*2,004*	*2,109*	*2,422*
Developed West	494	360	1,169	1,286	1,580	1,417	1,737	1,781	1,893	2,100
Less developed countries	54	228	206	275	132	199	172	238	231	336

a. Total adjusted to exclude Soviet economic aid deliveries to less developed countries and aid repayments from these countries made in goods.

Table 3

Soviet Hard Currency Trade Balance, Wheat Imports, and Gold Sales

Million US $

Year	Hard Currency Trade Balance	Wheat Imports a/	Gold Sales b/
1959	- 50	12	303
1960	-278	0	149
1961	-193	31	310
1962	-267	0	239
1963	-310	187	523
1964	-533	570	520
1965	-215	409	490
1966	-266	495	45
1967	+ 84	147	10
1968	-108	110	10
1969 c/	-313	10	Negl.

a. Including wheat flour; excluding transportation costs.
b. Minimum estimates. For details on Soviet gold production, sales, and reserves, see Table 5.
c. Preliminary.

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Table 4

Estimated Soviet Drawings and Scheduled Repayments on Western Medium-Term and Long-Term Credits a/

Million US $

	Estimated Drawings b/	Scheduled Repayments	Interest	Net Credits	Outstanding Debt at the End of the Year b/
1959	60	12	0	48	48
1960	125	37	2	86	136
1961	165	70	6	89	231
1962	180	106	10	64	305
1963	140	130	14	-4	315
1964	170	147	15	8	338
1965	190	149	17	24	379
1966	275	149	20	106	505
1967	305	152	29	124	658
1968	435	206	38	191	887
1969 c/	525	248	59	218	1,164

a. Estimates of drawings are based on data derived from contracts indicating delivery and credit terms and on Soviet imports of machinery and equipment. In general, early contracts (1959-64) involved 80%-85% credit and 5% interest. A large number of contracts since 1965 have involved 85% credit and 6% interest. Repayment periods for the earlier credits were usually three to five years following down-payment. Typical terms since 1965 have been eight years following delivery of equipment.

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c. Preliminary.

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Table 5

Soviet Gold Production, Sales, and Reserves

Million US $

Year	Production	Net Consumption a/	Sales b/	Other Additions and Withdrawals	Reserve Balance c/
1955	101	18	70	+11 d/	3,040
1956	104	20	154	+Negl. e/	2,970
1957	104	21	275	+21 d/	2,800
1958	109	22	182	+14 f/	2,720
1959	116	24	303	+18 f/	2,530
1960	124	27	149	N.A.	2,480
1961	133	28	310	N.A.	2,270
1962	143	30	239	N.A.	2,140
1963	153	30	523	N.A.	1,740
1964	164	32	520	N.A.	1,360
1965	176	34	490 g/	N.A.	1,010
1966	188	36	45	N.A.	1,120
1967	200	38	10 h/	-10 i/	1,260
1968	207	40	10	N.A.	1,410
1969	219	42	Negl.	N.A.	1,590
1970 j/	233	44	Negl.	N.A.	1,780

a. Net consumption is the gold issued to the domestic economy for use by industry and the arts in excess of that returned by the domestic economy for refining and eventual reissue.
b. Minimum estimates.
c. At the end of the year, rounded to the nearest $10 million. The range of error is 20%.
d. Total output of North Korea and Communist China.
e. Total output of North Korea and Communist China less a loan to Poland of $12.5 million.
f. Total output of North Korea.
g. Including a reported $180 million in Soviet and East European gold sold to Italian banks for debt service.
h. Soviet sales of industrial gold to West Germany.
i. Loan to Hungary.
j. Preliminary estimates.

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Table 6

Value of Soviet Orders for Plants and Equipment from the Developed West, a/ by Category

Million US $

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Total	*290*	*397*	*233*	*554*	*319*	*264*	*904*	*564*	*678*	*403*
Motor vehicle manufacturing	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	462	47	78 b/	52
Chemical and petrochemical	148	101	63	175	226	118	123	94 c/	90 c/	83
Ships and marine equipment	67	111	100	313	32	35	24	75	139	2
Timber and wood processing	N.A.	70	40	10	5	19	69	6	143	21
Textile manufacturing	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	59	106	9	4
Food processing	4	89	5	N.A.	N.A.	N.A.	52	41	31	9
Metalworking and metallurgy	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	17	22	34	30
Oil, gas, and pipeline equipment	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	19	12	35	132
Electronics	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	10	20	9	22
Other d/	71	26	25	55	56	92	68	142	110	49

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